

**REPORT OF THE AUDIT OF THE
KENTUCKY OFFICE OF INSURANCE
KENTUCKY ACCESS PROGRAM**

**For The Fiscal Year Ended
June 30, 2006**



**CRIT LUALLEN
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**EXECUTIVE SUMMARY
FINANCIAL STATEMENT AUDIT OF THE
KENTUCKY ACCESS PROGRAM**

**For The Fiscal Year Ended
June 30, 2006**

The Auditor of Public Accounts has completed the Kentucky Access Program's audit for the fiscal year ended June 30, 2006. We have issued an unqualified opinion on the governmental activities and major fund. Based upon the audit work performed, the governmental activities and major fund are presented fairly in all material respects.

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CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

To the People of Kentucky
Honorable Ernie Fletcher, Governor
Julie McPeak, Executive Director
Kentucky Office of Insurance

Independent Auditor's Report

We have audited the accompanying basic financial statements of the governmental activities and major fund of the Kentucky Access Program, a discretely presented component unit of the Commonwealth of Kentucky, as of and for the fiscal year ended June 30, 2006. These financial statements are the responsibility of the Program's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities and major fund of the Kentucky Access Program as of June 30, 2006, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Kentucky Access Program has not presented a Management's Discussion and Analysis (MD&A) as required by the Governmental Accounting Standards Board that accounting principles generally accepted in the United States has determined is necessary to supplement, although not required to be part of, the basic financial statements.



To the People of Kentucky
Honorable Ernie Fletcher, Governor
Julie McPeak, Executive Director
Kentucky Office of Insurance

In accordance with Government Auditing Standards, we have also issued our report dated October 10, 2006, on our consideration of the Program's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Crit Luallen", with a long horizontal flourish extending to the right.

Crit Luallen
Auditor of Public Accounts

Audit fieldwork completed -
October 10, 2006

**KENTUCKY OFFICE OF INSURANCE
KENTUCKY ACCESS PROGRAM
BALANCE SHEET/STATEMENT OF NET ASSETS**

June 30, 2006

	Balance Sheet Special Revenue Fund	Adjustments	Statement of Net Assets
<u>Assets</u>			
Cash and Investments	\$ 49,507,411	\$	\$ 49,507,411
Assessments Receivable	315,059		315,059
Premium Receivable	123,742		123,742
Interest Receivable	249,154		249,154
	<u>50,195,366</u>		<u>50,195,366</u>
<u>Liabilities</u>			
Incurred But Not Reported Claims	\$ 7,910,980		\$ 7,910,980
Accounts Payable	572,496		572,496
Unearned Income	1,116,319		1,116,319
Premium Application Suspense	288,187		288,187
	<u>9,887,982</u>		<u>9,887,982</u>
<u>Fund Balance/Net Assets</u>			
Fund Balances:			
Reserved	40,307,384	(40,307,384)	0
	<u>40,307,384</u>	<u>(40,307,384)</u>	<u>0</u>
Total Fund Balance	<u>40,307,384</u>	<u>(40,307,384)</u>	<u>0</u>
Total Liabilities and Fund Balances	<u>\$ 50,195,366</u>		
Net Assets:			
Restricted			40,307,384
Total Net Assets			<u>\$ 40,307,384</u>

The accompanying notes are an integral part of this financial statement.

**KENTUCKY OFFICE OF INSURANCE
KENTUCKY ACCESS PROGRAM
STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCE/STATEMENT OF ACTIVITIES**

For The Fiscal Year Ended June 30, 2006

	Statement of Revenues, Expenditures, and Changes in Fund Balance			Statement of Activities	
	Special Revenue Fund	Adjustments			
<u>Revenues</u>					
Tobacco Fund Allocation	\$ 16,746,210	\$	\$	16,746,210	
GAP Assessment Income	14,904,817			14,904,817	
Interest Income	1,886,582			1,886,582	
Federal Grant	266,985				
Premium Income/Charges for Service	20,770,264			20,770,264	
Total Revenues	54,574,858			54,574,858	
<u>Expenditures/Expenses</u>					
Benefits	39,076,676			39,076,676	
Budget Reduction Expense	10,287,900			10,287,900	
Other	2,483,223			2,483,223	
Total Expenditures/Expenses	51,847,799			51,847,799	
Excess of Revenues Over Expenditures/Expenses	2,727,059			2,727,059	
<u>Fund Balance/Net Assets</u>					
Beginning of the Year	37,580,325			37,580,325	
End of the Year	\$ 40,307,384	\$ 0	\$	40,307,384	

The accompanying notes are an integral part of this financial statement.

**KENTUCKY OFFICE OF INSURANCE
KENTUCKY ACCESS PROGRAM
NOTES TO FINANCIAL STATEMENTS**

June 30, 2006

Note 1. Description of Organization and Summary of Significant Accounting Policies

A. Organization

The Kentucky Access Program began operations January 1, 2001, by KRS 304.17B-001 to 304.17B-031 for the purpose of implementing a state sponsored "high risk" pool, as well as implementing an acceptable alternative mechanism within the meaning of 42 U.S.C. sec.300gg-44 (a)(1) so that Kentucky may preserve the flexibility over the regulation of health insurance coverage allowed by federal law. The purpose of the Guaranteed Acceptance Program (GAP) is to assist participating insurance companies in recouping losses incurred through insuring individuals who meet the statutory definition of "high risk."

GAP was established April 10, 1998, by KRS 304.17A-400 to 304.17A-480. The GAP fund of \$14,873,831 that existed at January 1, 2001, was transferred to the Kentucky Access Program. GAP is still in existence with approximately 135 insureds and is no longer accepting insureds. GAP will cease to exist when all insureds no longer participate in the program.

B. Organization's Significant Accounting Policies Follow:

1) Basis of Presentation

The Kentucky Access Program (Kentucky Access) is administered by the Kentucky Office of Insurance and is a discretely presented component unit of the Commonwealth of Kentucky. Kentucky Access has one fund; a special revenue fund that accounts for monies held by the Commonwealth to be distributed for specific operations of the state sponsored "high risk" pool. Since Kentucky Access is engaged in a single governmental program, the fund financial statements and the government-wide financial statements have been combined using a columnar format that reconciles individual line items of fund financial data to government-wide data on the face of the financial statements.

2) Measurement Focus/Basis of Accounting

The government-wide financial data of the combined financial statements report information on all of the activities of Kentucky Access using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows.

The fund financial data of the combined financial statements is accounted for on the modified accrual basis of accounting with a focus on the flow of current financial resources. Revenues are recognized when they become both measurable and available to finance expenditures of the current fiscal year. Expenditures are recorded when they are measurable which, generally, is when the related liability is incurred.

**KENTUCKY OFFICE OF INSURANCE
KENTUCKY ACCESS PROGRAM
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)**

**Note 1. Description of Organization and Summary of Significant Accounting Policies
(Continued)**

B. Organization's Significant Accounting Policies Follow: (Continued)

3) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

4) Revenue Recognition

Funding for Kentucky Access is provided by statute and is composed of appropriations from the Tobacco Settlement Agreement Fund; enrollee premium payments; assessments on insurers; premium taxes collected under KRS Chapter 136 from any insurer and any retaliatory taxes collected under KRS 304.3-270 from any insurer, for accident and health premiums that are in excess of the amount of the premium taxes and retaliatory taxes collected for the calendar year 1997; gifts, grants, or other voluntary contributions; and interest or other earnings on the investment of monies in the Kentucky Access fund.

Revenues for the fiscal year ended June 30, 2006 are composed of: health insurance premiums in the amount of \$20,770,264; GAP assessment income in the amount of \$14,904,817; interest income in the amount of \$1,886,582; and a tobacco fund allocation of \$16,746,210, of which \$10,287,900 was transferred to the General Fund of the Commonwealth of Kentucky by House Bill 267.

5) Fund Balance/Net Assets

Governmental fund equity is classified as fund balance. Fund balance is further classified as reserved and unreserved, with unreserved further split between restricted and unrestricted. As of year-end, Kentucky Access's fund balance is classified as reserved.

Government-wide equity is classified as net assets and is restricted for insurers' losses.

6) Budgetary Comparisons

Budgetary comparison schedules will not be presented given that Kentucky Access is included as part of the Office of Insurance budget.

**KENTUCKY OFFICE OF INSURANCE
KENTUCKY ACCESS PROGRAM
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)**

Note 2. Cash and Investments

The Office of Insurance participates in the Commonwealth of Kentucky's cash and investment pool, which is available for use by all funds under the auspices of the State Investment Commission as authorized under KRS 42.500 et al. Therefore, it follows the policies established by the Commonwealth for pooled cash and investments. The risk of disclosures related to deposits and investments are reported in the Commonwealth's Comprehensive Annual Report. At June 30, 2006, the carrying amount of the Kentucky Access Program's pooled deposits and investments was \$49,343,070.

In addition, Kentucky Access had money outside the investment pool in two accounts in the amount of \$164,341. Deposits are exposed to custodial credit risk if they are not covered by depository insurance or the deposits are a) uncollateralized, b) collateralized with securities held by the pledging financial institution, or c) collateralized with securities held by the pledging financial institution's trust department or agent not in the depositor's name. As of June 30, 2006, non-pooled deposits were covered by FDIC insurance or a properly executed collateral security agreement.

Note 3. Receivables

Receivables at June 30, 2006, were composed of assessments receivable of \$315,059, interest receivable of \$249,154, and premiums receivable of \$123,742. Assessments receivable is made up of \$13,384 from Humana, and claims refunds receivable of \$301,675. The interest receivable represents the amount due to Kentucky Access from the Commonwealth of Kentucky's cash and investment pool. Under KRS 304.17A-470 (2), all the funds in the program account must be held at interest.

Under GAP, participating insurers are reimbursed up to the amount of their program plan losses from funds of GAP. The GAP participating insurers for the year ended June 30, 2006 were Anthem and Humana. Anthem and Humana respectively claimed losses payable for the calendar year 2005 totaling \$1,492,461 and \$72,234.

Note 4. Liability for Unpaid Claims/Risk Pools

Liabilities for unpaid claims include estimated provisions for both reported and unreported claims incurred. Unpaid liabilities are generally adjusted regularly based on historical experience and include estimates of future trends in claims severity and frequency and other factors, which could vary as the claims are ultimately settled. Kentucky Access has claims experience beginning in March 2001, which is used as a basis in establishing reserves to meet future claims losses. Kentucky Access's outside actuarial consultants have expertise in establishing reserve levels for other high-risk pools and knowledge of the claims experience of GAP. They used that expertise and knowledge to establish claims reserve liabilities in the amount of \$7,910,980 as of June 30, 2006.

**KENTUCKY OFFICE OF INSURANCE
KENTUCKY ACCESS PROGRAM
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)**

Note 4. Liability for Unpaid Claims/Risk Pools (Continued)

In operating under the Kentucky Access Division in the Office of Insurance, KRS 12.050 and KRS 304.2-060 guides the appointments of an appropriate division director as appointed by the Commissioner of Insurance. Also, the Guaranteed Acceptance Program, as established by KRS 304.17A-400 to 304-17A-480, helps participating insurance companies to recover losses from individuals who met the "high risk" pool category by transferring the funds to Kentucky Access.

Under the program, no referral fees are paid to Kentucky Access; however, Kentucky Access does pay a referral fee to those agents who enroll members into the program. A provider network is then established, or a provider network is created by contracting with an insurer for a statewide provider network. Under KRS 304.17B-011 the established provider network is available and limited only to Kentucky Access enrollees.

A third-party administrator, chosen through the state bidding process, administers Kentucky Access. The administrator develops and establishes policies and procedures for enrolled participants and potential enrollees. However, premium rates charged do not fully cover health care costs; thus, claims exceeding premium rates are covered by the Kentucky Access fund.

Changes in Kentucky Access Program's claims liability amount in Fiscal Years 2006 and 2005 were:

	Fiscal Year 2006	Fiscal Year 2005
Beginning of fiscal year liability	\$ 7,910,980	\$ 7,910,980
Claims and claims adjustments incurred		
Claims and claims adjustment payments		
	<hr/>	<hr/>
Balance at Fiscal Year End	<u>\$ 7,910,980</u>	<u>\$ 7,910,980</u>

Note 5. Premium Income

Premium income is prorated over the term of the contract, with the earned premium representing the expired term of the policies.

Note 6. Changes in Accounting Principles, Reporting Practices, and Prior-Period Adjustments

The fund balance/net assets as previously reported has been restated to correct balances for transactions that were for the prior-period. The net effect of these transactions is a decrease of \$36,964.

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS



CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

Julie McPeak, Executive Director
Kentucky Office of Insurance

Report On Internal Control Over Financial Reporting And
On Compliance And Other Matters Based On An Audit Of The Financial
Statements Performed In Accordance With Government Auditing Standards

We have audited the financial statements of the governmental activities and major fund of the Kentucky Access Program as of and for the fiscal year ended June 30, 2006, and have issued our report thereon dated October 10, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Kentucky Access Program's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance And Other Matters

As part of obtaining reasonable assurance about whether the Kentucky Access Program's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.



Report On Internal Control Over Financial Reporting And
On Compliance And Other Matters Based On An Audit Of The Financial
Statements Performed In Accordance With Government Auditing Standards
(Continued)

This report is intended solely for the information and use of management and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Crit Luallen", with a long horizontal flourish extending to the right.

Crit Luallen
Auditor of Public Accounts

Audit fieldwork completed -
October 10, 2006

